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Before the
FEDERAL COMMUNICATIONS COMMISSION
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FEDERAL COMMUNICATIONS COMMISSION
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In the Matter of Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended; and Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area	CC Docket No. 96-149

Comments of the Independent Data Communications Manufacturers Association

Herbert E. Marks
Jonathan Jacob Nadler
Adam D. Krinsky

Squire, Sanders & Dempsey
1201 Pennsylvania Avenue, N.W.
P.O. Box 407
Washington, D.C. 20044
(202) 626-6600

Counsel for the
Independent Data Communications
Manufacturers Association

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SUMMARY

In these comments, IDCMA highlights several aspects of the non-accounting separation and non-discrimination safeguards that are especially important to prevent BOC anti-competitive conduct in the manufacturing market.

Section 272 of the Telecommunications Act requires BOC separate affiliates to "operate independently" from their affiliated BOCs. IDCMA agrees with the Commission that this provision requires it to impose separation requirements that go beyond those specifically enumerated in Section 272. In particular, the Commission must make clear that the requirement to operate independently means that a separate affiliate may not engage in joint equipment design and development activities with its affiliated BOC. Nor may a separate affiliate engage in joint research activities with its affiliated BOC -- especially if such activity is related to the development of specific products. Section 272 also requires a BOC to treat non-affiliated entities in the <u>identical</u> manner in which it treats its separate affiliates. To implement this provision, the Commission must prevent the BOCs from discriminating in the provision of any information that could be used to develop customer premises equipment ("CPE").

In the <u>Interexchange Market</u> proceeding, the Commission has proposed to allow non-dominant IXCs to bundle service and CPE. Even if the Commission were to classify BOC separate affiliates as non-dominant in the provision of in-region interexchange service, however, it should not permit the BOC separate affiliates to bundle CPE. BOC separate affiliates are fundamentally different from non-dominant IXCs. Unlike traditional IXCs, each BOC separate affiliate is closely related to an entity that retains monopoly power in its core market. Experience under the <u>Computer II</u> regime suggests that even the most rigorous safeguards will

not fully eliminate a BOC's incentive and ability to use its as-yet-undiluted monopoly power in the local exchange market to impede competition in the competitive markets it seeks to enter. For example, a BOC could use its market power to pressure customers, who may wish to purchase only the separate affiliate's interexchange service, to also purchase affiliate-provided CPE.

Because the same piece of CPE generally is used in connection with both interexchange and local exchange service, CPE bundling can enable the separate affiliate to help its affiliated BOC obtain "account control" by providing an end-to-end offering consisting of CPE, local exchange service, and interexchange service. A BOC's ability to "lock-in" customers would be especially great in cases in which the CPE could interoperate only with BOC transmission service. This would increase the ability of the BOC to deter customers from switching to competitive local exchange carriers once such providers begin to enter the market, thereby undermining one of the central goals of the Telecommunications Act.

The BOC separate affiliates will soon be allowed to offer packages that contain interexchange and local exchange services. When that occurs, the Commission must ensure that CPE is not bundled into such a package. Failure to do so would allow the separate affiliate to circumvent the prohibition on bundling CPE with local exchange service by bundling CPE with a "token" interexchange service offering and then packaging the interexchange service with local exchange service.

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Comments of the
Independent Data Communications Manufacturers Association

The Commission has requested comments regarding the rules necessary to implement the non-accounting separation requirements and non-discrimination safeguards specified in Section 272 of the Telecommunications Act of 1996 ("Telecommunications Act").[1] The Independent Data Communications Manufacturers Association ("IDCMA") urges the Commission to implement these provisions in a manner that is consistent with the express

[1] See Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended and Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area, CC Docket No. 96-149, FCC 96-308, ¶ 2 (rel. July 18, 1996) ("Notice") (citing 47 U.S.C. § 272).

language of the statute and the intent of the Congress. To do so, the Commission must require maximum separation between a Bell Operating Company ("BOC") and its separate affiliate, and must prevent the BOC from showing any preference to its separate affiliate. In these comments, IDCMA highlights several aspects of the separation and non-discrimination requirements that are especially important to prevent BOC anti-competitive conduct in the manufacturing market.

The Commission also seeks comment as to whether a BOC separate affiliate should be classified as non-dominant in the provision of in-region interexchange service.[2] Even if the Commission chooses to classify the BOC separate affiliates as non-dominant, it should not allow the separate affiliates to bundle customer premises equipment ("CPE") with in-region interexchange service.

I. THE COMMISSION MUST REQUIRE "MAXIMUM SEPARATION" AND BAN ANY PREFERENCE (¶¶ 57-60 & 72-79)

A. The Requirement That A Separate Affiliate "Operate Independently" From The Affiliated BOC Requires The Commission To Impose Maximum Separation Between the BOC and Its Affiliate (¶¶ 57-60)

In drafting the Telecommunications Act, Congress recognized that the BOCs have a strong incentive to use their continuing monopoly power in the local exchange to impede competition in adjacent markets. Section 272 therefore provides that a BOC may only engage in in-region interexchange services, manufacturing, and interLATA information services through a separate affiliate.[3] In adopting this provision, Congress expressly required that the separate

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[2] See Notice at ¶ 2.

[3] See 47 U.S.C. § 272.

affiliate "operate independently" from its affiliated BOC.[4] In the Notice, the Commission tentatively concluded that this provision requires it to impose separation requirements that go beyond those specifically enumerated in Section 272.[5] IDCMA is in full agreement with this conclusion. The Notice goes on to ask whether the Commission can satisfy this obligation by adopting either the separation requirements contained in the Competitive Carrier Orders or those adopted in Computer II.

The relatively weak separation requirements adopted in the Competitive Carrier proceeding would not be sufficient to fulfill Congress' intent. The Competitive Carrier safeguards were intended to allow independent local exchange carriers -- which the Commission believed posed fewer competitive threats than the BOCs -- to offer interexchange service as non-dominant carriers.[6] The Commission specifically concluded that these safeguards would not have been adequate to allow the BOCs to be classified as non-dominant.[7] That conclusion remains valid today.

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[4] See id. § 272(b)(1).

[5] See Notice at ¶ 57. Section 272 specifically requires the BOC separate affiliate to: maintain separate books, records, and accounts; have separate officers, directors, and employees; obtain credit on a basis that would not subject the affiliated BOC to liability for default; and conduct all transactions with the affiliated BOC on an arm's-length basis. See 47 U.S.C. §§ 272(b)(2)-(5).

[6] See Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorization Therefor, Fifth Report and Order, 98 F.C.C.2d 1191, 1198 (1984).

[7] See id. at 1198 n.23.

The Computer II separation requirements,[8] in contrast, address the precise situation at issue here: BOC participation in the manufacturing and information service markets.[9] Recognizing that the BOCs exercise monopoly power in the provision of local exchange service, the Computer II rules required "maximum separation" between the BOCs and their competitive ventures. Although the Telecommunications Act is intended to foster competition in the local exchange, the fact remains that the BOCs today enjoy much the same monopoly power they did during Computer II. Until that situation changes, IDCMA believes that the maximum separation rules adopted in Computer II must serve as the starting point for the development of appropriate rules governing the relationship between the BOCs and their separate affiliates.

A key element of the maximum separation regime adopted in Computer II was the requirement that the BOC separate affiliate (then referred to as a separate subsidiary) must use facilities that are physically separate from the affiliated BOC. As the Commission recognized, "to allow the subsidiary to share physical space with an affiliated carrier is to significantly increase the potential for the carrier to discriminate in favor of its affiliated subsidiary."[10] Such discrimination is the very antithesis of the independent operations mandated by Section 272.

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[8] See Amendment of Section 64.702 of the Commission's Rules and Regulations, 77 F.C.C.2d 384 (1980) ("Computer II Final Order"), recon., 84 F.C.C.2d 50 (1980), aff'd sub nom. Computer and Communications Indus. Ass'n v. FCC, 693 F.2d 198 (D.C. Cir. 1982), cert. denied, 461 U.S. 938 (1983).

[9] Although Computer II imposed requirements on the Bell System, following divestiture the separate affiliate requirements were extended to the BOCs. See BOC Separations Order, 95 F.C.C.2d 1117 (1983).

[10] Computer II Final Order, 77 F.C.C.2d at 477.

Therefore, as in Computer II, the Commission must require that a BOC separate affiliate use facilities that are physically separate from those of its affiliated BOC.[11] This conclusion is confirmed by the House Committee Report, which expressly states that the separate affiliate provision "mandates fully separate operations and property."[12]

In order to implement the requirement that a separate affiliate operate independently, the Commission also must make clear that an affiliate may not engage in joint equipment design and development activities with its affiliated BOC. Such a requirement is fully consistent with Section 273 of the Telecommunications Act, which allows a BOC to engage in "close collaboration with any manufacturer . . . during the design and development" of CPE.[13] This provision codifies the BOCs' right, established under the Modification of Final Judgment ("MFJ"), to undertake the type of collaborative activities that any purchaser would engage in when dealing with a supplier -- such as providing performance specifications to independent manufacturers. Such collaboration, however, must not include BOC participation in actual design and development activities, which constitute manufacturing and may only be performed by separate affiliates and other manufacturers.[14]

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[11] A separate facilities requirement would not preclude collocation of a separate affiliate's equipment on its affiliated BOC's property if the collocation agreement was the result of arms-length negotiations and the same collocation opportunities were made available to similarly situated non-affiliated entities.

[12] H.R. Rep. No. 204, 104th Cong., 1st Sess. 79 (1995) (emphasis added).

[13] 47 U.S.C. § 273(b)(1) (emphasis added).

[14] See United States v. Western Elec. Co., 675 F. Supp. 655, 667-68 (D.D.C. 1987), aff'd 894 F.2d 1387 (D.C. Cir. 1990). The Decree Court recognized that the Bell System's anti-competitive conduct in manufacturing had occurred in design and development rather
(continued...)

The Commission also must make clear that, in order to operate independently, the separate affiliate may not engage in joint research activities with its affiliated BOC -- especially if such activity is related to the development of specific products. This, too, is consistent with Section 273, which expressly limits the BOCs' research activities to basic "research activities related to manufacturing," rather than applied research.[15]

B. Section 272 Bars a BOC from Providing Any Discriminatory Preference to Its Affiliate (¶¶ 72-79)

The Commission also seeks comment on what regulations are necessary to implement Section 272's prohibition of discrimination by a BOC on behalf of its separate affiliates.[16] IDCMA supports the Commission's tentative conclusion that this provision means what it says: a BOC must treat non-affiliated entities in the identical manner in which it treats its affiliates.[17]

The non-discrimination requirement has particular applicability to manufacturing. Section 272 bars a BOC from discriminating in favor of its separate affiliate in the provision of

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[14](...continued)
than in fabrication, and that these activities are an inherent part of manufacturing. See id. at 662-663. As a result, the Decree Court expressly prohibited the BOCs from engaging in design and development. Because the Telecommunications Act states that the term manufacturing has the same meaning as under the Consent Decree, see 47 U.S.C. § 273(h), the BOCs remain prohibited from engaging in actual design and development.

[15] 47 U.S.C. § 273(b)(2)(A).

[16] See id. § 272(c)(1) (A BOC "may not discriminate between that company or affiliate and any other entity in the provision or procurement of goods, services, facilities, and information, or in the establishment of standards.").

[17] See Notice at ¶ 73.

"information."[18] To implement this provision, the Commission must prevent the BOCs from discriminating in the provision of any information that could be used to develop CPE that can interoperate with its local exchange facilities or with any BOC service to which CPE is connected.[19] Such a requirement would compliment Section 273, which directs the Commission to prescribe rules to ensure that non-affiliated manufacturers have access to any information that a BOC makes available to a separate affiliate regarding "network protocols and technical requirements."[20]

II. THE COMMISSION SHOULD NOT ALLOW A BOC SEPARATE AFFILIATE TO BUNDLE CPE WITH IN-REGION INTEREXCHANGE SERVICE (¶ 108)

As part of the pending Interexchange Market proceeding, the Commission is considering a proposal to allow non-dominant IXCs to bundle CPE with interexchange service.[21] In the present proceeding, the Commission proposes to treat BOC separate affiliates as non-dominant in the provision of in-region interexchange service.[22] IDCMA has serious reservations about the classification of BOC separate affiliates as non-dominant. Even if the

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[18] 47 U.S.C. § 272(c)(1).

[19] This includes information regarding central office equipment -- such as Asymmetric Digital Subscriber Line ("ADSL") equipment -- that is "paired" with CPE at the subscriber's premises. If a CPE manufacturer were to gain exclusive or even early notice of information regarding central office paired equipment, it could benefit greatly in the development of paired CPE.

[20] Id. § 273(c)(3).

[21] See Policy and Rules Concerning the Interstate, Interexchange Marketplace, CC Docket No. 96-61, FCC 96-123, ¶¶ 84-91 (rel. Mar. 25, 1996).

[22] See Notice at ¶ 108.

Commission so decides, however, the Notice does not address whether the separate affiliates would be allowed to bundle CPE with in-region interexchange service. IDCMA believes that the Commission should prohibit the separate affiliates from doing so.

The Commission's CPE No-Bundling Rule,[23] adopted in Computer II, prohibits carriers from requiring their transmission service customers to purchase or lease carrier-provided CPE. The Rule also bars carriers from offering "special deals" available only to customers who agree to purchase both transmission service and CPE from the carrier. Since its inception, the Rule has applied to all carriers -- not just those that the Commission has classified as dominant. By ensuring a competitive CPE marketplace, the Commission noted just last year, the Rule has increased user choice, improved equipment quality, and reduced price.[24] In adopting the Telecommunication Act, Congress expressly preserved the No-Bundling Rule.[25]

[23] See 47 C.F.R. § 64.702(e).

[24] See Verilink Corporation's Petition for Rulemaking to Amend the Commission's Part 68 Rules to Authorize Regulated Carriers to Provide Certain Line Build Out Functionality as a Part of Regulated Network Equipment on Customer Premises, 10 FCC Rcd 8914, 8917 (Com. Car. Bur. 1995) (denying petition to rebundle line build out functionality with regulated transmission service); see also NYNEX Telephone Companies Tariff F.C.C. No. 1, Transmittal No. 127, Memorandum Opinion and Order, 9 FCC Rcd 1608 (1994) (denying petition to bundle premises-based multiplexing equipment with regulated transmission service); BellSouth Telecomm. Digital Transmission Serv. F.C.C. Tariff No. 1, Order, 7 FCC Rcd 5504 (1992) (denying petition to bundle premises-based multiplexing equipment with regulated transmission service); BellSouth's Petition for Declaratory Ruling, Memorandum Opinion and Order, 6 FCC Rcd 3336 (1991) (denying petition to bundle line build out functionality with regulated transmission service).

[25] See 47 U.S.C. § 549(d)(2). Indeed, Congress directed the Commission to extend its no-bundling policy to the cable infrastructure. See id. § 549(a).

IDCMA -- joined by representatives of the information service and consumer electronics retailers communities -- has opposed the Commission's proposal to eliminate the pro-competitive, highly successful No-Bundling Rule in the interexchange market.[26] In its comments, IDCMA predicted that, if the Commission allowed non-dominant IXCs to bundle CPE with interexchange service, it would be required to determine whether local exchange carriers should be afforded similar authority once they enter the interexchange market.[27] As IDCMA observed, the process of determining "when a carrier can, and cannot, bundle . . . is likely to consume significant administrative resources, while leading to the erosion of the No-Bundling Rule."[28] The present proceeding demonstrates that IDCMA was correct.

The best course of action, IDCMA believes, is for the Commission to preserve the current prohibition on CPE bundling by any carrier in any market.[29] This approach is consistent with the Commission's legal obligations, as well as its long-standing and successful

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[26] See Comments of the Independent Data Communications Manufacturers Association, CC Docket No. 96-61 (filed Apr. 25, 1996) ("IDCMA Comments); Comments of the Information Technology Association of America, CC Docket No. 96-61 (filed Apr. 25, 1996); Comments of the Consumer Electronics Retailers Coalition, CC Docket No. 96-61 (filed Apr. 25, 1996). See also Letter from William J. Johnson, Director, Telecommunications, Woolworth Corporation, to William F. Caton, Acting Secretary, FCC (July 5, 1996); Letter from John A. Anheier, Director of Information Systems Services, Payless Cashways, Inc. to William F. Caton, Acting Secretary, FCC (July 9, 1996).

[27] See IDCMA Comments at 26-27.

[28] Id. at 27.

[29] Cf. Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, First Report and Order, CC Docket No. 96-98, FCC 96-325, ¶ 997 (rel. Aug. 8, 1996) ("We believe that, even for telecommunications carriers with no market power,the duty to interconnect directly or indirectly is central to the 1996 Act and achieves important policy goals.") The same can be said for CPE interconnection.

policies, which have fostered a highly competitive market for CPE. Even if the Commission were to abandon its long-standing policy and allow non-dominant IXCs to bundle CPE, however, it should not permit the BOC separate affiliates to do so.

There is a fundamental difference between a non-dominant IXC and a BOC separate affiliate. Non-dominant IXCs generally are not affiliated with entities that possess market power. In contrast, each BOC separate affiliate is closely related to an entity that retains monopoly power in its core market. To be sure, the safeguards contained in Section 272 are intended to prevent the BOC from "sharing" its market power with its separate affiliate. Nevertheless, experience under the Computer II regime suggests that even the most rigorous safeguards will not fully eliminate a BOC's incentive and ability to use its as-yet-undiluted monopoly power in the local exchange market to impede competition in the competitive markets it seeks to enter.[30] For example, a BOC could seek to use its market power to pressure customers, who may wish to purchase only the separate affiliate's interexchange service, to also

[30] BOC violations in the CPE and equipment sector, for example, have included CPE bundling, network disclosure, and equipment procurement infractions. See, e.g., NYNEX Telephone Companies,Tariff F.C.C. No. 1, 8 FCC Rcd 7684 (1993) (finding that NYNEX Enterprise Service's "customer premises 'intelligent' multiplexing equipment" constituted a violation of the No-Bundling Rule and was not allowed under the multiplexer exception); NYNEX Telephone Companies, Tariff F.C.C. No. 1, Transmittal No. 234 (filed Oct. 18, 1993) (following IDCMA petition for network disclosure information, see Petition to Reject Or, in the Alternative, to Suspend and Investigate (filed Nov. 2, 1993), NYNEX acknowledged that additional disclosure was required); New York Telephone Company and New England Telephone Company: Apparent Violations of the Commission's Rules and Policies Governing Transactions With Affiliates, 5 FCC Rcd 866 (1990) (finding that a NYNEX separate non-regulated subsidiary had overcharged it regulated affiliate for telecommunications equipment).

purchase affiliate-provided CPE. In order to eliminate this risk, the Commission should not allow the separate affiliates to bundle interexchange service with CPE.

There is a second significant difference between traditional IXCs and the BOC separate affiliates. The same piece of CPE generally is used in connection with both local exchange and interexchange service.[31] If an IXC were to bundle CPE with its interexchange service, the equipment most likely would be used in connection with the local exchange service provided by an unaffiliated LEC. In contrast, if a BOC separate affiliate were to bundle CPE with its in-region interexchange service, the equipment almost certainly would be used in connection with the local exchange service provided by its affiliated BOC.

If bundling were permitted, the separate affiliate -- which may be reintegrated with the BOC in just three years -- would be able to help the BOC to obtain "account control" by providing an end-to-end offering consisting of CPE, local exchange service, and interexchange service. This would increase the ability of the BOC to deter customers from switching to competitive local exchange carriers once such providers begin to enter the market. The BOCs' ability to "lock-in" customers would be especially great in cases in which the CPE that the separate affiliate bundles could interoperate only with the BOC's transmission service.[32] The

[31] Cf. North Carolina Utilities Commission v. FCC, 537 F.2d 787, 791-92 (4th Cir.), cert. denied, 429 U.S. 1027 (1976) (the same CPE is used for both intrastate and interstate purposes).

[32] The use of affiliate-provided CPE to benefit the BOC plainly would violate the affiliate's duty to operate independently. The chance of this anti-competitive conduct is especially likely to occur in services that involve paired equipment. See supra note 19.

end-result would be to thwart the growth of local exchange competition, thereby denying user choice and directly undermining one of the central goals of the Telecommunications Act.

Looking ahead, BOC separate affiliates soon will be offering packages that contain both in-region interexchange service and local exchange service.[33] If the prohibition on bundling dominant local exchange service with CPE is to have any remaining vitality, the Commission must prevent the separate affiliate from bundling CPE with such combined interexchange-local exchange packages. Indeed, failure to do so would allow the separate affiliate to circumvent the No-Bundling Rule by bundling CPE with a "token" interexchange service offering, and then packaging the interexchange service with the BOC's local exchange service.[34] This would signal the death knell of the pro-competitive, highly successful No-Bundling Rule. The Commission should make clear that it will not allow this to occur.

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[33] See 47 U.S.C. § 272(g)(1) (allowing BOC separate affiliates to market BOC local exchange service if other entities are permitted to do so as well).

[34] According to press accounts, in an effort to sidestep separation requirements, some of the BOCs are planning to use their separate affiliate to offer in-region interexchange and local exchange services, ostensibly in competition with their affiliated BOC's local exchange service. See Leslie Cauley, Bells Sidestep Local-Service Regulations, WALL ST. J., July 15, 1996, at A3. Such a strategy would make it even easier for the BOC to evade the prohibition against bundling CPE and local exchange service.

CONCLUSION

For the foregoing reasons, the Commission should require maximum separation between the BOCs and the separate affiliates, should bar any form of discrimination by a BOC in favor of its affiliate, and should prohibit the affiliates from bundling customer premises equipment with its interexchange service offerings.

Respectfully submitted,

Jonathan Jacob Nadler

Herbert E. Marks
Jonathan Jacob Nadler
Adam D. Krinsky

Squire, Sanders & Dempsey
1201 Pennsylvania Avenue, N.W.
P.O. Box 407
Washington, D.C. 20044
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